Nos. 21,607 and 21,607-A

United States Court of Appeals

For the Ninth Circuit

D. Clifford Crummey and
Ethel Elizabeth Crummey,
Petitioners,

vs.

Commissioner of Internal Revenue,
Respondent.

On Petition to Review Decisions of the Tax Court of the United States

BRIEF FOR PETITIONERS

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OPENING STATEMENT

This is a Petition to Review a determination of the Tax Court of the United States that there is a combined deficiency in gift tax of the Petitioners for the year 1962 in the amount of $990.00 and for the year 1963 of $1,487.72 (R. 83, 89). Jurisdiction was conferred on the Court below under 26 USCA Section 7442. Jurisdiction is conferred on this Court by 26 USCA Sections 7482 and 7483.

The asserted deficiency is based upon the Respondent's erroneous determination that the gifts in trust by the Petitioners were gifts of future interests not qualifying for the annual exclusion pursuant to Sec-

tion 2503 of the 1954 Internal Revenue Code. The case was submitted to the Court below fully stipulated (R. 27-30) and, therefore, this Court can treat this case as a trial *de novo.*

FACTS INVOLVED

The controversy involves the proper determination of the Petitioners' liability for federal gift taxes for the calendar years 1962 and 1963; all of the facts in this case were stipulated (R. 27-30) and in summary the facts are as follows:

On February 12, 1962, Petitioners executed, as Grantors, an Irrevocable Living Trust Agreement for the benefit of their four children, namely, John Knowles Crummey, born February 1, 1940; Janet Sheldon Crummey, born June 21, 1942; David Clarke Crummey, born July 6, 1947; and Mark Clifford Crummey, born February 20, 1951. Petitioners initially contributed $50.00 to the trust and on June 20, 1962, contributed $4,267.77, on December 15, 1962, contributed $49,550.00, and on December 19, 1963, contributed $12,797.81. Each beneficiary had a right to demand at any time (up to and including December 31, of the year in which a transfer to his or her trust had been made), the sum of $4,000.00 or the amount of the transfer from each donor, whichever was less, payable in cash immediately upon receipt by the Trustee of the demand in writing, and, in any event, not later than December 31, in the year in which such transfer was made. Furthermore, the trust provided that if a child was a minor at the time of such gift or

failed in legal capacity for any reason, the child's guardian could have made such demand on behalf of the child, (set out in full at R. 67). This provision, hereinafter referred to as the *demand clause* is set out in full at R. 67.

The Trustee was required to hold the property in equal shares for the children of the Grantors. In addition thereto, the Trustee in his discretion, could distribute the trust income to each beneficiary until the beneficiary attained the age of 21. From age 21 to 35, the Trustee was required to distribute trust income to each beneficiary, and when the beneficiary reached 35, the Trustee was authorized, in his discretion, to distribute trust income to each beneficiary or his issue.

During the years 1962 and 1963, no beneficiary demanded any part of his trust property, nor were distributions made to any of the beneficiaries by the Trustee. Petitioner D. Clifford Crummey had been appointed Guardian of the Person and Estate of his minor children, namely, John K. Crummey, Janet P. Crummey, David C. Crummey, and Mark Clifford Crummey, on December 20, 1951 (R. 94-95).

In filing their federal gift tax returns for 1962 and 1963, Petitioners each claimed a $3,000.00 gift tax exclusion for each of the four trust beneficiaries, constituting a total claimed exclusion by each Petitioner of $24,000.00 for the two years in question. The Commissioner of Internal Revenue held that each Petitioner was entitled to only one $3,000.00 exclusion for 1962 and one $3,000.00 for 1963 (for the shares of the adult beneficiaries), on the ground that gifts in trust

to the minor beneficiaries were "future interests", and therefore disallowed exclusions totalling $18,000.00 for each Petitioner for the two years in question. The Tax Court allowed each Petitioner an additional $3,000.00 exclusion for 1962, and an additional $3,000.00 exclusion for 1963, and determined the deficiencies for the years 1962 and 1963 for the Petitioners, as aforesaid.

QUESTION PRESENTED

1. Do the transfers in trust for the benefit of the minor beneficiaries constitute gifts of present interests qualifying for annual gift tax exclusions under the provisions of Section 2503 of the Internal Revenue Code of 1954?

STATUTES AND REGULATIONS INVOLVED

The parts of the gift tax law (Section 2503(a) and (b), Internal Revenue Code, Title 26 United States Code) and Section 25.2503-3(a) and (b) of the Regulations, which are chiefly involved in this proceeding are copied hereunder for the convenience of the Court.

Internal Revenue Code:

Sec. 2503. Taxable Gifts

(a) General Definition.—The term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (sec. 2521 and following).

(b) Exclusions From Gifts.—In the case of gifts (other than gifts of future interest in prop-

erty) made to any person by the donor during the calendar year 1955 and subsequent calendar years, the first $3,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

Regulations:

Section 25.2503-3 provides in part as follows:

Section 25.2503-3. Future Interest in Property.

(a) No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar year. "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, not (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.

(b) An unrestricted right to the immediate use, possession, or enjoyment of property or the

income from property (such as a life estate or term certain) is a present interest in property. An exclusion is allowable with respect to a gift of such an interest (but not in excess of the value of the interest). If a donee has received a present interest in property, the possibility that such interest may be diminished by the transfer of a greater interest in the same property to the donee through the exercise of a power is disregarded in computing the value of the present interest, to the extent that no part of such interest will at any time pass to any other person (see example (4) of paragraph (c) of this section). For an exception to the rule disallowing an exclusion for gifts of future interests in the case of certain gifts to minors, see 25.2503-4.

POINTS ON WHICH THE PETITIONER RELIES

I. A minor beneficiary of a Trust is permitted under California law to exercise his right under the Trust Agreement to demand partial distribution from the Trustee.

II. In the alternative, under California law, a minor beneficiary over fourteen years of age, has the capacity to exercise his right under the Trust Agreement to demand partial distribution from the Trustee.

III. In the alternative, under California law, a parent as the *natural guardian* of the person of his minor children who are beneficiaries of a Trust, has the right to make demand upon the Trustee for partial distribution of the trust pursuant to the provisions of the Trust Instrument.

IV. The Tax Court erred in denying petitioner's motion for further trial for the purpose of introducing additional evidence to the effect that the petitioner, D. Clifford Crummey, had been appointed Guardian of the Person and Estate of his minor children by a Court of competent jurisdiction.

ARGUMENT

I. A MINOR BENEFICIARY OF A TRUST IS PERMITTED UNDER CALIFORNIA LAW TO EXERCISE HIS RIGHT UNDER THE TRUST AGREEMENT TO DEMAND PARTIAL DISTRIBUTION FROM THE TRUSTEE.

In its opinion (R. 73), the Tax Court correctly held that:

> Paragraph Three of the Trust provides that in the case of a minor beneficiary, his guardian "may" demand the allowable share of an annual gift made to his trust. We interpret the Grantors' use of the word "may" in Paragraph Three as permissive rather than mandatory. Thus, if a minor beneficiary is not prohibited by state law from making his own demand, he has the right under the trust instrument to do so without the assistance of a guardian.

This right is, of course, the critical element which characterizes the gift as a present interest qualifying for the exclusion under Section 2503 (all references herein are to the Internal Revenue Code of 1954 unless otherwise noted). After correctly interpreting the Trustor's intent as set out in the Trust instrument, the Court noted (R. 75) the California statutory pro-

visions which define a minor as one under twenty-one years of age; which establishes a minor's incapacity to appoint an Agent or to sue in his own name; and which establish the relief provision permitting minors to avoid certain contracts, California Civil Code, Sections 25, 33, 35 and 42. From these three isolated and limited statutory distinctions between adults and minors the Court leaps to its gross misinterpretation of the California law (R. 75):

> Accordingly, we hold that David and Mark Crummey themselves, could not have made an effective demand of their trust property during the years in question.

In addition to the three disabilities, not the least in point on the issue in this case, enumerated by the Court, it might have pointed out that a minor may not vote in California, Cal. Const., Art. II, Sec. 1, nor qualify for a driver's license under the age of sixteen years, California Vehicle Code Section 12512. But, how does a review of this type of statutory enactment assist in determining whether or not a minor has the capacity to demand distribution of entirely gifted property? For this we must look elsewhere.

One source is the Tax Court opinion in the present case. In adopting, for the purposes of determining legal capacity to make this demand upon the Trustee, the California distinction between minors under age eighteen and those over that age relating to certain types of contracts, the Court held that a minor over eighteen could make such a demand. To bolster this

holding it cited *Oyama v. California,* 332 U.S. 633 (1948), a case which sustained the right of a six year old child to own real estate acquired by gift from his father. In *Oyama,* the United States Supreme Court rendered unconstitutional the State of California's attempted escheat of the property of an infant American whose father was an alien, ineligible for citizenship. At page 634 Chief Justice Vinson speaking for the Court said:

> The first of the two parcels in question, consisting of six (6) acres of agricultural land in Southern California, was purchased in 1934 when Fred Oyama was six years old.

Page 637:

> The second parcel, an adjoining two (2) acres, was acquired in 1937, when Fred was nine (9) years old.

At page 640 the Court succinctly recapitulates the Federal and California law in this area:

> By Federal statute enacted before the Fourteenth Amendment but vindicated by it, the States must accord to all citizens the right to take and hold real property (citing 8 U.S.C. 42). California, of course, recognizes both this right and the fact that infancy does not incapacitate a minor from holding realty.

The United States Supreme Court cited *Estate of Yano,* 188 Cal. 645, 649, 206 Pac. 995, 998 (1922), and *People v. Fugita,* 215 Cal. 166, 169, 8 P. 2d 1011, 1012 (1932), as its authority for the California law. The Supreme Court has consistently recognized that the Fourteenth Amendment as applied to State action

requires that there be no discrimination against the rights of minors. Since the Tax Court decision in this present case was rendered, the Supreme Court has again spoken, this time in a criminal action. In *Application of Gault,* 87 Supreme Court 1428 (1967), speaking for the majority Justice Fortas noted:

> Accordingly, while these cases (concerning the application of due process to juvenile delinquency proceedings) relate only to the restricted aspects of the subject, *they unmistakably indicate that, whatever may be their precise impact, neither the Fourteenth Amendment nor the Bill of Rights is for adults alone.* (Emphasis added.)

It is clear from analysis of the regard of the Court of the rights of a minor, that the Trustee of the Trust here in question could not legally resist the demand of the minor beneficiary for the payment up to the Four Thousand Dollar limit each year. *This is* not to say that the Trustee could not, nor should not insist upon the appointment of a legal guardian to *receive the monies so demanded.* But, the necessity of appointment of a Guardian of the Estate does not preclude the gifting of a present interest. (Revenue Ruling 54-400, Cumulative Bulletin 1954-2 319.) An analysis of the statutory and case authority in California prompts the conclusion that it is the public policy of this state not to curtail the minor in every facet of his activities, but rather to give effect to his actions and decisions limited only by the desire to protect minors by preventing them from handling their own money directly. 26 Cal. Jur. 2d 634, Sec. 6, Infants. The *Oyama, Yano* and *Fugita*

decisions stand for the propositions that in California a minor is a citizen capable of acquiring and disposing of property like other citizens. An infant may receive a gift, and his acceptance thereof is presumed; or as some Courts say when the gift is beneficial the law accepts it for him. *De Lavillin v. Evans,* 39 Cal. 120; *Turner v. Turner,* 173 Cal. 782, 161 Pac. 980.

The California legislature has comprehensively regulated the dealings of minors, but by failing to control many areas, it recognizes the ability of infants to handle the situations themselves. The California Court has said:

> Under the doctrine of *parens patriae* the state, acting through the Legislature, has the inherent power to provide protection to all person *non sui juris,* and to make and enforce such rules and regulations as it deems proper for their management and affairs . . . (There is a) . . . general scheme for regulation of minor's *property rights. Darlington v. Basalt Rock Co.,* 157 Cal. App. 2d 575, 321 P.2d 490.

In the *Yano* case, *supra* the Court discusses the important right of a minor to acquire property:

> She (the alien petitioner's daughter), was a natural born American citizen and as such entitled to acquire and hold property real and personal, her infancy did not incapacitate her from becoming seized from the title of real estate. Delivery to, and acceptance by an infant will be presumed. When a deed clearly beneficial to an infant is given to him, his acceptance will be presumed, and the recording of the deed is a sufficient delivery.

Further:

> The disability of infants are really privileges which the law gives and which they may exercise in their own benefits, the object of the law being to secure infants from damaging themselves or their property by their own improvident act or prevent them from being imposed upon by the fraud of others. 43 C.J.S. 41, Section 19, Infants.

The directions given, or the demands made, by infants upon banks, savings institutions and corporations are given full force and effect as if made by an adult. California Financial Code Sections 850, 853, 7600 and 7606, California Corporations Code Sections 2221 and 2413.[1]

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[1]California Financial Code, Section 850.

Minors. A bank account by or in the name of a minor shall be held for the exclusive right and benefit of such minor and shall be paid to such minor or to his order and payment so made is a valid release and discharge to the bank for such deposit or any part thereof.

California Financial Code, Section 853.

Trust Accounts. Whenever any deposit is made in a bank by any person which in form is in trust for another, but no other or further notice of the existence and terms of a legal and valid trust is given in writing to the bank, in the event of the death of the Trustee, the deposit or any part thereof may be paid to the person for whom the deposit was made, whether or not such person is a minor.

California Financial Code, Section 7600.

Minors. Associations may issue shares or investment certificates to a minor of any age and receive payments thereon by or for such minor. Such minor is entitled to withdraw, transfer, or pledge any shares or certificates owned by him and to receive from the association all dividends, interest, or other money due thereon in the same manner and subject to the same conditions as an adult. The receipt or acquittance of a minor constitutes a valid release and discharge of the association for the payment of dividends, interest, or other money due to such minors.

California Financial Code, Section 7606.

Payments Upon Death of Trustee or Guardian. When a person holding shares or investment certificates as trustee or guardian

Is there any reason to fail to acknowledge an infant's capacity to make a similar demand upon the Trustee of a Trust for his benefit? It appears not; the California rule being that the right to acquire and enjoy property belongs to minors as well as adults, even though the management and control of the estates of minors is subject to guardianship. *Otto v. Union National Bank of Pasadena,* 38 Cal. 2d 233, 226 P. 2d 29, and the second opinion at 238 P. 2d 961.

After citing *Fondren v. Commissioner,* 324 U.S. 18 (1945) which defines a present interest to be the right to presently use, possess or enjoy the property, the Tax Court correctly poses the only issue in this case (R. 72):

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dies and no notice of the terms, revocation, or termination of the trust or guardianship is given in writing to the association, the withdrawal or other value of the shares or investment certificates or any part thereof may be paid to the beneficiary or ward. If no beneficiary or ward has been designated in writing to the association, the withdrawal or other value or any part thereof may be paid to the trustee's or guardian's executor or administrator. Such payment by any association is a valid and sufficient release and discharge of the association for the payment whether or not such payment is made to a minor.
California Corporations Code, Section 2221.

Minor Shareholder; Guardian. Shares standing in the name a minor may be voted and all rights incident thereto may be exercised by his guardian in person or by proxy, or in the absence of such representation by his guardian, by the minor, in person or by proxy, whether or not the corporation has notice, actual or constructive, of the nonage or the appointment of a guardian, and whether or not a guardian has been in fact appointed.
California Corporations Code, Section 2413.

Transfer by Minor or Incompetent; Immunity of Corporation. A domestic corporation or a foreign corporation keeping transfer books in this state is not liable to a minor or incompetent person in whose name shares are of record on its books for transferring the shares on its books at the instance of the minor or incompetent or for the recognition of or dealing with the minor or incompetent as a shareholder, whether or not the corporation had notice, actual or constructive, of the nonage or incompetency.

> . . . In order that the gift in question be held to constitute gift of present interests, and Petitioner's right to the gift tax exclusions sought to be upheld, the evidence must show that the minor beneficiaries during 1962 and 1963, could have effectively demanded whatever trust property they were entitled to at least to the amount of the $3,000 exclusions Petitioners sought to take for such gifts.

Upon analysis, the accurate interpretation of the California law compels an affirmative answer to this question.

II. IN THE ALTERNATIVE, UNDER CALIFORNIA LAW, A MINOR OVER FOURTEEN YEARS OF AGE, HAS THE CAPACITY TO EXERCISE HIS RIGHT UNDER THE TRUST AGREEMENT TO DEMAND PARTIAL DISTRIBUTION FROM THE TRUSTEE.

The public policy of California in recognizing the capacity of a minor fourteen years of age or over to form intelligent decisions in matters of serious consequence is exemplified by the provisions in the California Probate Code which permit the fourteen year old to nominate and to petition the Court for appointment of a guardian.[2]

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[2]California Probate Code, Section 1406.

Guardian of Minor; Rules for Appointment. In appointing a general guardian of a minor, the court is to be guided by what appears to be for the best interest of the child in respect to its temporal and mental and moral welfare; and if a child is of sufficient age to form an intelligent preference, the court may consider that preference in determining the question. If the child resides in this state and is *over fourteen years of age,* he may nominate his own guardian, either of his own accord or within ten days after being duly cited by the court; and such nominee must be appointed

The Courts in interpreting these sections (and the predecessor sections in the earlier California code) find no difficulty in recognizing the maturity and capacity of a fourteen year old to make an intelligent selection of the person to serve as his guardian. Language in an important recent case is as follows:

> Where a minor owns property, that fact is ordinarily sufficient to support a finding that the appointment of a guardian of the minor's estate is "necessary or convenient", and the preference of the minor, if fourteen years old, prevails over the obligation of any person, including the parent, provided that the nominee is found to be suitable. *Guardianship of Kentera,* 41 Cal. 2d 639, 643, 262 P. 2d 317 (1953).

In the early definitive case, *Guardianship of Kirkman,* the Court said:

> . . . it is clear that it means that a minor over fourteen years of age has the absolute right to replace the guardian appointed by the court when

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if approved by the court. When a guardian has been appointed for a minor under fourteen years of age, the minor, at any time after he attains that age, may nominate his own guardian, subject to the approval of the court. (Emphasis added.)

California Probate Code, Section 1440.

Authority to Appoint; Petition; Guardianship Over More Than One Minor; Bond. When it appears necessary or convenient, the superior court of the county in which a minor resides or is temporarily domiciled, or in which a nonresident minor has estate, may appoint a guardian for his person and estate, or person or estate. The appointment may be made upon the petition of a relative or other person on behalf of the minor, or on the petition of the minor, *if fourteen years of age.*

The court may issue letters of guardianship over the person or estate, or both, of more than one minor upon the same application in its discretion. When there is an application for more than one minor, the court may permit a joint or separate bond in such multiple application. (Emphasis added.)

> he was under fourteen years of age, with one of his own selection provided always that the person selected by him is, in the estimation of the court, a suitable or proper person.
>
> The whole statutory scheme contemplates the absolute right of the minor to have a guardian of his own selection after he is fourteen years of age, provided always he selects a person who is, in the judgment of the court, a suitable person to act as guardian. 168 Cal. 688, 144 Pac. 745 (1914).

Again in *Estate of Meiklejohn:*

> . . . the statute gives the minor the authority to select a new guardian, and does not make such power dependent upon the relationship. 171 Cal. 247, 152 Pac. 734.

And in *Estate of McSwain:*

> Becoming over sixteen years of age, the minor, had the right to nominate her guardian, and such nominee, if appointed by the court must be appointed. . . . The minor nominated *Craycroft* to be the Guardian of her person, and her estate, and the court approved the nomination. His appointment as guardian of the estate is therefore imperative. 176 Cal. 287, 168 Pac. 117.

Is not the degree of maturity requisite in the intelligent choice of a guardian of one's entire estate at least as great as that required to determine whether or not to make a demand upon the Trustee for the payment of $4,000 to one's legally appointed guardian? Reason compels an affirmative answer.

III. IN THE ALTERNATIVE, UNDER CALIFORNIA LAW, A PARENT AS THE NATURAL GUARDIAN OF THE PERSON OF HIS MINOR CHILDREN WHO ARE BENEFICIARIES OF A TRUST, HAS THE RIGHT TO MAKE DEMAND UPON THE TRUSTEE FOR PARTIAL DISTRIBUTION OF THE TRUST PURSUANT TO THE PROVISIONS OF THE TRUST INSTRUMENT.

At the outset a distinction must be made between the *legal guardianship* of the estate or property of a minor and the *natural guardianship* prevailing in the relationship of parent and his minor child. The first is a legal status created by a judicial order and issuance of Letters of Guardianship. The second is defined as follows:

> One of the natural rights incident to parenthood, and one supported by law and sound public policy, is the right to *care* and custody of a minor child. This right is frequently referred to as "natural guardianship", "guardianship by nature", or "parental guardianship". 24 Cal. Jur. 2d 248, Section 57, Guardian and Ward.

Analytically, the provision in the *demand clause* referring to demand by a *guardian* includes a *natural guardian;* there was in existence at all times such a *natural guardian* (the beneficiaries' father) during the years in question who could have effectively demanded the trust property; the gift to them is thereby characterized as one of a present interest. Note that the Petitioner's contention is not that the parent-*natural guardian* has a right to manage or control his child's property, but that he, as *natural guardian* has the right and even the duty to make a demand upon the Trustee for distribution pursuant to the *demand*

clause, if in his opinion the child's well being is thereby served. Of course, should the rights and duties incident to this natural guardianship prompt the making of such a demand, then it would be necessary for the Court to issue letters of *legal guardianship* to empower someone to receive the money so demanded. California Probate Code, Section 1400 et seq., *Bogert On Trusts,* Sec. 814. The Tax Court, citing California Civil Code, Section 202, states the California law that a parent has no control over his child's property. (R. 76.) This is true; but as already suggested, the parent as *natural guardian* does have custody and care of his child, and such duty of care might well require the parent to exercise his right under the *demand clause* when, in his opinion the child's well-being is thereby served. The Tax Court both misinterpreted the California law of *natural guardianship,* and confused this relationship with the *legal guardianship,* urging that public policy in California disfavors the appointment of a parent as *legal guardian.* The Tax Court states (R. 77):

> Petitioner's contention is further weakened by California's decisional law which clearly indicates judicial disapproval of the selection of a parent for purposes of managing his child's estate.

To bolster this conclusion the Court below cited *In Re Howard's Guardianship,* 24 P.2d 482. In *Howard,* a totally unrelated 1933 decision of the California Supreme Court, the Court reversed the lower Court's nonsuit of a father's petition for removal of a bank as *legal guardian* of the estate of his minor child. The

Court noted that a guardian must be entirely disinterested and since the bank was also Trustee of a trust, one of the beneficiaries of which was the petitioner's child, it was not disinterested in the fiduciary sense.

Contrary to the interpretation by the Tax Court of the local law in this regard, California specifically favors the parent as guardian of his minor child's person and estate.

> California Probate Code, Section 1407—*Order Of Preference In Appointment.* Of persons equally entitled in other respects to the guardianship of a minor, preference is to be given as follows: (1) to a parent.
>
> . . . . . .

Other California Probate Sections having to do with relatively small estates of minors, disputed claims of minors, compromises or covenants not to sue and the like, demonstrate this legislative preference for appointment of parents as *legal guardian.* California Probate Code, Sections 1430 and 1431.

The cases are consistent with this strong public policy:

> The law is well settled that the parent is entitled to the guardianship of his child in preference to any other person in the absence of the finding of unfitness or incompetency. *Hartman v. Moller,* 99 Cal. App. 57, 277 P. 2d 875 (1929).

As a matter of fact, it has been held that a non-parent seeking to be appointed guardian of a child

has the burden of proving the parent's unfitness. *In Re Clark's Guardianship,* 32 Cal. Rptr. 111, 217 Cal. App. 2d 808 (1963). Cf. *Guardianship of De Brath,* 18 Cal. App. 2d 697, 64 P. 2d 96 (1937), and even in cases where the Court has sustained the appointment of a nonparent it is held that the best interest of a child requires that a parent be his guardian unless the parent is unfit. *In Re Kile's Guardianship,* 89 Cal. App. 2d 445, 200 P. 2d 886 (1949) (wife-killer father), *In Re Smith's Guardianship,* 147 Cal. App. 2d 686, 306 P. 2d 86 (1957) (accused husband-killer mother) and *In Re Newell's Guardianship,* 10 Cal. Rptr. 29, 187 Cal. App. 2d 425 (1961) (fourteen year old unwed mother).

The Tax Court and the Respondent looked beyond the four corners of the Trust instrument and reasoned that even if the parents as natural guardians *could* make the requisite demand, they *would* not do so thereby frustrating their carefully considered plan of gifting. From this it was concluded that the right although it existed in appearance, it did not in fact. It is possible to foresee that the best interest of the child would be served by continuing to leave all of the transferred property in the trust and to draw the income therefrom with the remainder eventually going over to their grandchildren. *But if circumstances changed, as they so often do, between the time of making the trust transfer and the end of the year this conscientious natural guardian could demand at least enough to provide the necessary subsistence for a minor beneficiary.*

Is there necessarily an inconsistency between the "trust provisions (which) indicate a clear intention on the part of petitioners to restrict the use of the trust principal and thereby postpone its enjoyment for the benefit of their grandchildren rather than their children" (R. 78) and the fiduciary duty of petitioners as *natural guardians* to exercise their right pursuant to the *demand clause* if under changed circumstances the children's well-being required it? The law has not hesitated to impose fiduciary standards in such cases. Consider, in the field of corporate law, the shareholder-director, who as director must act for the benefit of the corporation notwithstanding a possible adverse effect on the market value of his shares. He is not, however, precluded from serving on the Board because of his share holdings. Similarly, in the law of trusts, a remainderman may serve as Trustee and is held to the same lofty standards as any trustee. The same is true in the present case. If a demand should have been made for the child's well-being and the parent sought to disregard the child's benefit to carry out his own intended plan, he could be held for a breach of his fiduciary duty. In such a case, those minor beneficiaries over fourteen could, of course, under the Probate Code sections already cited, petition the Court themselves for the appointment of a *legal guardian*. To hold otherwise, is to disregard the traditional equity powers of the Courts as *parens patriae,* and to overlook the entire concept of fiduciary duties. In its opinion, the Tax Court cited *Howard* as requiring that the guardian of an estate should be an entirely disinterested person, free from

temptation or the suspicion thereof. The relevance of this case has already been questioned, but the statement therein that a guardian must be disinterested merely restates this fiduciary duty which, it is submitted, can and must be served to avoid liability. Unlike the situation in *Howard* the trusts in question here have Trustees independent from the Trustors and beneficiaries, and the parent as *natural guardian* must, when acting in that capacity, meet these high fiduciary standards which proscribe self-dealing and any conduct which fails to benefit the minor.

Both the Sixth and Seventh Circuits have analyzed the tax consequences of similar *demand clauses,* and, reversing the Tax Court, have allowed gift tax exclusions ruling that the right to demand by or on behalf of minor beneficiaries created present interests.

In the case of *Kieckhefer v. Commissioner,* 15 T.C. 111, Reversed by CA-7, 189 F. 2d 118, 40 A.F.T.R. 661, the donor created a trust for the benefit of an infant grandson. Paragraph 13 of the trust instrument in *Kieckhefer* provides as follows:

> This trust has been created by the donor after full consideration and advice. Upon such consideration and advice the donor has determined that this said trust shall not contain any right in the donor to alter, amend, revoke or terminate it. The beneficiary shall be entitled to all or any part of the trust estate or to terminate the trust estate in whole or in any part at any time whenever said John Irving Kieckhefer or the legally appointed guardian for his estate shall make due

> demand therefor by instrument in writing filed with the then trustee and upon such demand being received by the trustee the Trustee shall pay said trust estate and its accumulations, or the part thereof for which demand is made, over to the said John Irving Kieckhefer or to the legally appointed guardian for his estate who made such demand on his behalf.

In the *Kieckhefer* case the Commissioner based his argument on the fact that the infant beneficiary was one month old when the trust was created, did not make an effective demand, and, further, that the minor beneficiary had no legally appointed guardian at the time of the execution of the trust. The Tax Court sustained the Commissioner. On Appeal, the Seventh Circuit Court of Appeals reversed the Tax Court and commented upon the fact that the conditions and restrictions upon which the Commissioner relied in his determination that this was a gift of a future interest were not imposed by the trust instrument but resulted solely because of the disability of the beneficiary due to the fact that he was a minor. The Court disagreed with the Commissioner that every gift to a minor is one of a future interest. At 189 F. 2d 121, 40 A.F.T.R. 664, the Court reasoned as follows:

> Suppose in the instant situation that the beneficiary had been an adult rather than a minor. Such adult, of course, could immediately have made a demand upon the Trustee and have received the trust property. We suppose that such a gift unquestionably would be one of a present

> interest. But because the beneficiary is a minor, with the disabilities incident thereto, it is reasoned that the gift is of a future interest because the disabled beneficiary is not capable of making a demand.

The *Kieckhefer* reasoning applies to the case in issue. The Respondent has allowed exclusions for gifts in trust made to an adult offspring apparently for the reason that an adult can effectively make a demand of his share of the gift at any time. However, Respondent disallowed an exclusion for gifts in trust for the benefit of minors on the basis that a minor is incapable of making a demand of his share of a gift in trust.

In the case of *Gilmore v. Commissioner,* 20 T.C. 579, reversed by 213 F. 2d 520, 54-1 U.S.T.C., Para. 10,948, the Petitioner made gifts of corporate stock to trusts created for the benefit of seven minor grandchildren. The trust instrument provided for distribution of the trust estate and the net income therefrom as follows:

> The trustees shall pay the principal and all income from the trust estate to Sherwood M. Boudeman upon demand by the said Sherman M. Boudeman . . .

At the time of the creation of the trusts, each of the minor grandchildren was less than ten years of age. They were all in good physical and mental health and legal guardians were not appointed for them. This Court, in discussing the effect of the above cited *demand clause,* commented as follows at 20 T. C. 583:

> It is true that the first provision for distribution of the trust estate quoted above, taken by itself, would render all gifts those of present interest, for that provision imposes upon the Trustees the duty to transfer the entire corpus and income of the trust to the beneficiaries *upon demand without qualification and independent of any contingency.* (Emphasis supplied.)

This Court's decision, however, was not based on the disability of the beneficiaries but upon other provisions of the trust. At 20 T.C. 583, it stated:

> . . . that later provisions in granting discretionary powers to the trustees have so limited the beneficiaries' rights to distribution upon demand as to render such right a virtual nullity.

The Court thus determined that these provisions limited the beneficiaries' right so as to convert the gifts into those of future interests regardless of whether or not the beneficiaries were minors.

The Sixth Circuit Court of Appeals reversed the Tax Court, holding that the language of the demand clause was sufficient to create gifts of present interest. The Court during the course of its opinion stated:

> . . . And again, we come back to the unqualified directions to the trustees to pay the principal or income of the trusts *on demand of the beneficiary.* Cf. Kieckhefer . . . . It is the right given to the donee, in the trust instrument, to use, possess, or enjoy and not the capacity of the donee, which determines whether the gift is one of present interest or future interest.

In its concluding remarks the Court of Appeals stated as follows:

> The government, however, submits that even though the beneficiaries were adults, the gifts in this case would be contingent to the infant beneficiaries, and that no beneficiary, adult or infant, could make an effective demand that the trustees pay him the entire estate at any time—in spite of the fact that the trust instrument expressly provides for such payment on demand. We are unable to concur in such a view, so obviously contrary to the donor's intention and so clearly contrary to the language of the trust instrument.

A careful examination of the demand clause set forth in the David Clifford Crummey and Ethel Elizabeth Crummey Irrevocable Living Trust Agreement No. 2 reveals that a beneficiary is entitled to demand at any time during the year up to $4,000 of his share of gifts made in trust during the year. In the *Gilmore* case, in which the Court relied on *Kieckhefer* as authority, the trust provided that a demand may be made by a child despite his age. It did not require the appointment of a legal guardian. The trust in the case in issue is similar to that of *Gilmore*. No legal guardian is required by the trust instrument. The trust merely provides that the beneficiary *may demand*.

In the *Gilmore* case, the beneficiaries ranged from seven years to only two months of age in the year in which gifts were made in trust. As the Tax Court stated at 20 T.C. 583, the *demand clause* in *Gilmore*,

taken by itself, would result in the gifts being those of a present interest. It is therefore clear that a similar demand clause in the case in issue results in gifts in trust which are gifts of present interests, for which exclusions are allowable to Petitioners in computing tax due on their 1962 and 1963 Federal gift tax returns.

In a more recent decision, the Tax Court cited both *Gilmore* and *Kieckhefer* and held that a *demand clause* for minor beneficiaries would support gift tax exclusions. See *George W. Perkins,* 27 T.C. 601 (1956). In that case, Petitioners made gifts to trust created for the benefit of minor grandchildren. The beneficiaries, their duly appointed guardians, or their parents were given the right to demand and receive all or part of the trust income or principal. The parents were fully capable of supporting their children. No guardians were appointed except in a few instances. Respondent disallowed the exclusions on the basis that the gifts were those of future interests. The Tax Court held that the Respondent's position might have been tenable if the power to demand income or principal was limited to the beneficiaries *or* duly appointed *legal guardians.* However, the Tax Court held that the adult parents of the beneficiaries (their *natural guardians* under California law) were not incompetent to exercise the power to demand, and since Respondent was unable to show that a demand by the parents could have been properly resisted, the gifts in trusts were of present interests. At page 605 the Court commented as follows:

The parents of the beneficiaries were given the power by clear and unambiguous language to demand and receive on behalf of their respective children all or part of the principal and accumulated income. We cannot see how this power is "vitiated" by the opinion of the settlors that it would be unwise to exercise it under existing conditions or their expectation, however it may be justified by subsequent events, that there would in fact be no such exercise. Respondent has cited no authority, and we know of none, that a demand by the parents could have been properly resisted. The trusts in literal terms created present interests.

We agree with respondent that the circumstances surrounding the creation of the trusts and the making of the gifts are relevant factors, to be considered along with the trust instruments themselves. However, we cannot find from such facts that the gifts were not indeed of present interests. It is admitted that petitioners expected that the power given to the parents of the beneficiaries would not be exercised, at least in the absence of a substantial change of circumstances, and this expectation has apparently proved justified. The parents were and have continued to be financially able to support their children without recourse to trust income or principal. Nonetheless, they have continuously had the right to make such demand since the time the gifts were made. The existence or nonexistence of that right at the relevant time must determine the nature of the gifts, not the subsequent conduct of the parents in choosing whether or not to exercise it. Whatever the motives of the petitioners, their hopes or expecta-

> tions, we cannot hold that the parents of the beneficiaries did not indeed have the right to make demand at any time. They are clearly given such right by the terms of the trust instruments. The surrounding circumstances show only that it was unlikely that they would choose to exercise it, but do not negate its existence.

Finally, the Court summarizes its opinion as follows on page 606:

> In the instant proceeding petitioners decided to and did create trusts for the benefit of their minor grandchildren, and thereafter made gifts of property to those trusts. Neither the trusts nor any of the gifts were unreal or illusory. Petitioners in every relevant transaction did what they purported to do. In so doing, they chose the path of least tax cost. There is nothing improper in so doing, and their actions are no less valid and real than had they chosen instead the path leading to greater tax liability.

In the instant case, Respondent has conceded that gifts to children over twenty-one years of age qualify as gifts of present interest for which exclusions are allowable on the gift tax returns. This concession is inconsistent with Respondent's contention that gifts to minor children are not allowable because made too late in the year and that no notice was given to the beneficiary that he could make a demand for his share of the gift. Respondent has established one standard for adult children and another for minor children. However, there is no evidence that notice of gifts in trust was given to adult children and not given to

minor children. The circumstances parallel those of *Perkins.* Even if it is assumed that donors did not contemplate that a demand would ever be made because of the fact that they were amply able to support their children, the fact is that a demand could have been made, and consequently, the gifts in trust were those of present interests. A minor child in the *Crummey* case *could* have made a demand through his guardian which, in the event of no appointment of a legal guardian, would be his parent *(natural guardian)*, or, for that matter, he could have himself made the demand through the trustee of the trust with respect to claiming his share of the gift made during the year.

IV. THE TAX COURT ERRED IN DENYING PETITIONER'S MOTION FOR FURTHER TRIAL FOR THE PURPOSE OF INTRODUCING ADDITIONAL EVIDENCE TO THE EFFECT THAT THE PETITIONER, D. CLIFFORD CRUMMEY, HAD BEEN APPOINTED GUARDIAN OF THE PERSON AND ESTATE OF HIS MINOR CHILDREN BY A COURT OF COMPETENT JURISDICTION.

If, as the Tax Court concluded, it is required that a *legal guardian* be appointed to exercise the beneficiaries' right under the *demand clause,* the Court erred in denying petitioner's motion for further trial. Subsequent to the entry of the Tax Court's decision, petitioners informed their counsel that petitioner D. Clifford Crummey had been appointed guardian of the person and the estate of his minor children in 1951. (R. 94-95.) Denial of this motion precluded the presentation of evidence of the guardianship appointment, a fact which is material to a correct decision of the case under the rationale adopted by the Tax Court. *Stockyards National Bank of St. Paul,* 153 F. 2d 708, affirmed on other grounds 169 F. 2d 39, *Chatman Phenix National Bank and Trust Company v. Halvering,* 87 F. 2d 547, *Charles A. Polizzi v. Commissioner,* 247 F. 2d 875, *Commissioner v. Wells,* 132 F. 2d 405.

CONCLUSION

It therefore follows that:

(a) Respondent's disallowance of gift-tax exclusions under the provisions of Sec. 2503 of the Internal Revenue Code of 1954 is in error. There existed at all times some one who had the right to make an effective demand upon the trustee for a distribution under the

terms of the trust, such person being the minor beneficiaries themselves; or in the alternative, those over age fourteen, or in the alternative, the parents as natural guardians of the persons of the minor beneficiaries; or in the alternative, the petitioner D. Clifford Crummey as legally appointed guardian of the persons and estate of the minor beneficiaries. The existence of the right to demand characterized the gifts in trust as present interests qualifying for the exclusion.

(b) In the alternative, the Tax Court erred in denying Petitioner's motion for further trial.

Dated, Sacramento, California,
June 15, 1967.

Respectfully submitted,
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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN B. CINNAMON.